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DEPARTMENT OF GENERAL SERVICES
REPORT ON REVIEW OF STATE OFFICE SPACE
LEASING VERSUS CONSTRUCTION PRACTICES

AUGUST 1974

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California Legislature

VINCENT THOMAS
CHAIRMAN

ROOM 4126, STATE CAPITOL
SACRAMENTO, CALIFORNIA 95814
(916) 445-7906

TONY BOLOBNOW, COORDINATOR
(916) 445-7907

EVE OSTOJA, OFFICE MANAGER
(916) 445-7908

SENATORS

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August 12, 1974

The Honorable Speaker of the Assembly
The Honorable President of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members:

Transmitted herewith is the Auditor General's report pertaining to the State Department of General Services' practices of leasing versus construction of office space. Approximately 43 percent of the estimated 13 million square feet of office space presently occupied by state personnel, exclusive of state universities, colleges and institutions, is leased.

Between December 1971 and December 1973, the amount of leased office space increased from 4.6 million square feet to 5.6 million square feet, or 21 percent. For this period, the cost of leased space increased from \$18.1 million to \$24.2 million annually, or 34 percent. The amount of office space owned by the state remained the same during this period.

While construction costs have also increased substantially, it would be economically advantageous for the state to construct additional office buildings for its employees in Sacramento and Los Angeles, areas which contain a high concentration of state employees. Such construction could be effected on land presently owned by the state.

As an actual example of the economical advantage of construction versus leasing, the construction of state buildings 8 and 9, located in Sacramento, has resulted in an approximate savings of \$428,000 annually, when compared to what the state would have been paying to lease comparable space.

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On the contrary, an example of the high cost of a current state lease is the leasing of 48,000 square feet of office space in Sacramento in the Park Executive Building for three legislative agencies, the Offices of the Legislative Analyst, Legislative Counsel and the Auditor General, and one executive branch agency, the Secretary of State. The \$372,000 annual lease cost for this space is approximately \$100,000, or 37 percent greater than the cost to the state for comparable space in buildings 8 and 9.

By using the \$3,659,000 of funds already contained in the state's budget for the leasing of 535,000 square feet of selected high-cost office space in Sacramento and Los Angeles, the state could finance construction of two office buildings containing comparable space.

As an example of how this could be accomplished, the state could construct one office building in Sacramento and another in Los Angeles, each having an estimated useful life of at least 50 years, at a total estimated cost of \$28,962,000. The two state-owned buildings would contain 535,000 total square feet. The total financing of these buildings, including interest expense, could be effected over a maximum period of 22.4 years through the utilization of an annual appropriation of \$3,659,000.

Based on the remaining useful lives of these two buildings, a cash savings of approximately \$66,000,000 would accrue to the state if the buildings were constructed instead of leased. In this example, the state would have full ownership in a period of less than one-half of the buildings' useful lives.

The Auditor General has recommended that the Department of General Services request that the monies currently appropriated on an annual basis in the state's budget for leasing high-cost office space be used instead to finance construction of office buildings.

The Department of General Services has not released a report of state building requirements and plans for satisfying those requirements, even though the report was required to be submitted to the Joint Legislative Budget Committee by November 1, 1973.

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Department of General Services' officials stated they had transmitted the report to the Agriculture and Services Agency which reviewed the report and requested various revisions. The Auditor General has concluded that this report contains valuable information pertaining to the state's office space needs and has recommended that the report be immediately released to the Joint Legislative Budget Committee.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Vincent Thomas".

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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SUMMARY OF FINDINGS, RECOMMENDATIONS,
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FINDING

By using \$3.6 million of funds already contained in the state's budget for leasing 535,000 square feet of selected high-cost office space, the state could finance construction of office buildings containing comparable space.

4

RECOMMENDATION

We recommend that the department request that monies currently appropriated on an annual basis in the state's budget for leasing high-cost office space be used instead to finance construction of office buildings.

10

SAVINGS

Based on current lease rates and the size buildings discussed in this report, proper implementation of this recommendation will result in estimated cash savings to the state of approximately \$66,000,000 over the remaining useful life of the buildings after full payment of the construction and interest costs. Further, the state will have full ownership of these buildings.

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FINDING

The Department of General Services has not released a report of state building requirements and plans for satisfying those requirements, even though the report was required to be submitted to the Joint Legislative Budget Committee by November 1, 1973.

12

RECOMMENDATION

We recommend that the Department of General Services immediately release its report on state building space requirements and plans to the Joint Legislative Budget Committee for their review and consideration.

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BENEFITS

Implementation of this recommendation will enable the Legislature to better evaluate the state's office space needs.

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INTRODUCTION

In response to a legislative request, we have reviewed the operations of the Space Management Division and the Long Range Facilities Planning Office under the Department of General Services.

The Space Management Division provides managerial services for state-owned and leased office and warehouse space, except that used by colleges, hospitals and other state institutions. Our review of this division's activities consisted primarily of reviewing the division's lease practices to assure that the state is receiving the best value possible from leasing activities. We found in general that the Space Management Division is properly meeting this objective.

The Long Range Facilities Planning Office is responsible for developing and maintaining long-range facilities plans within the state to determine future agency space requirements.

About 43 percent of the estimated 13 million square feet of office space presently occupied by state personnel, exclusive of the state universities, colleges and institutions, is leased.

Between December 1971 and December 1973 the amount of leased office space increased from 4.6 million square feet to 5.6 million square feet, or 21 percent. For this period the cost of leased space increased from

\$18.1 million to \$24.2 million annually, or 34 percent. The amount of office space owned by the state remained the same during this period.

This significant rise in the amount of leased space is attributable, in part, to the following factors:

1. State building programs have been curtailed during the last several years.
2. Two large state facilities, the west wing of the State Capitol Building in Sacramento and the state office building located on First Street in Los Angeles, do not meet state earthquake standards and are being vacated. Employees in these facilities are being relocated into leased buildings.
3. A continuing demand for space brought about by increases in the state work force.

No new major state office buildings have been constructed in Sacramento since 1969, when state office buildings 8 and 9 were completed. Since 1963, however, the state has acquired 106 acres of land and improvements adjacent to the State Capitol Building at an approximate cost of \$22 million. Only about 14 percent of this property, however, has been developed to provide state office building space. Of the remaining property, representing a state investment of about \$19 million, 45 percent is rented to others, 32 percent is used for employee parking, and 9 percent is vacant land.

FINDINGS

BY USING \$3.6 MILLION OF FUNDS ALREADY
CONTAINED IN THE STATE'S BUDGET FOR LEASING
535,000 SQUARE FEET OF SELECTED HIGH-COST
OFFICE SPACE, THE STATE COULD FINANCE
CONSTRUCTION OF OFFICE BUILDINGS CONTAINING
COMPARABLE SPACE.

Without increasing the \$3.6 million already appropriated in the state's budget for leasing 535,000 square feet of high-cost office space in Sacramento and Los Angeles, the state could finance construction of office buildings containing comparable space over a period of 20 to 23 years.

Presently the state is leasing a total of 1.3 million square feet of office space in Sacramento at an annual cost of \$5.6 million, and 552,000 square feet in central Los Angeles at an annual cost of \$3.5 million. Lease rates on prime office space in these two cities have increased substantially in recent years, and the state has increased the amount of such space it has leased.

Construction costs have also increased substantially. However, since the state now leases such large amounts of office space at high rates, it would be economically advantageous for it to construct additional office buildings for its employees in Sacramento and Los Angeles. Such construction would be effected on land presently owned by the state.

State office buildings 8 and 9, located in Sacramento, are an example of the economies provided by state ownership of buildings in an area where there is a high concentration of state employees.

These two structures were completed in 1969 at an approximate cost of \$20 million. They provide about 428,000 square feet of modern office space. The annual cost of financing construction of these buildings is approximately \$1.2 million over a 25-year period. Maintenance of these buildings costs an additional \$1.2 million annually. This total present annual cost of \$2.4 million represents an average rate of \$5.60 per square foot, which is approximately \$1.00 per square foot less than the average lease rate for newer privately-owned structures in Sacramento. This difference, when projected over the amount of usable space in buildings 8 and 9 shows that the state's current savings as a result of ownership of these buildings is approximately \$428,000 annually.

The 25-year loan repayment period on these structures is substantially less than their estimated useful life of at least 50 years. Even greater annual savings will be realized in future years after the state has fully paid for the construction costs, and only maintenance costs will then be incurred.

Examples of the high cost of current leases, which the state must pay in order to provide adequate facilities for its operations in Sacramento and Los Angeles, are described below. There is a high concentration of state employees in both the Sacramento and Los Angeles areas.

- In Sacramento, 48,000 square feet of office space is leased for three legislative agencies, the Offices of Legislative Analyst, Legislative Counsel, and Auditor General, and one executive branch agency, the Secretary of State, in the Park Executive Building

located across the street from the State Capitol. This building, which was occupied in 1972, has facilities similar to those provided in state-owned office buildings 8 and 9, which were occupied in 1969. The \$372,000 annual lease cost for this space is approximately \$100,000, or 37 percent greater than the cost to the state for comparable space in buildings 8 and 9. We recognize that if buildings 8 and 9 had been constructed at the same time as the Park Executive Building, the construction costs for buildings 8 and 9 would have been greater.

- In December 1973, the state signed a lease for a building in Los Angeles to provide 136,000 square feet of space for the Department of Justice, Court of Appeals, 2nd Appellate District and California Supreme Court. The building, which is scheduled for occupancy in September 1974, is leased for five years. The state has an option for renewal of the lease for an additional five years. The annual cost of this space, together with 5,000 square feet of storage space and parking facilities for 353 cars, is \$1,250,000. Total rent to be paid during the five-year firm term of the lease is approximately \$6,250,000. If the renewal option is exercised, as would seem likely if state facilities are not built, the additional five-year term could cost the state approximately \$5,520,000. The lease rate for the five-year optional period, which is at a reduced amount, is subject to escalation, however, if property taxes are increased. Assuming no property tax increase, the lease cost for the entire ten-year period would be approximately \$11,770,000.

In comparison, the state could construct a building of this size for an estimated \$7,631,000. This cost is based on July 1974 estimates provided by the Office of Architecture and Construction of the Department of General Services.

The following example illustrates how the state could meet some of its needs for office space by constructing in Sacramento and Los Angeles, buildings having an estimated useful life of at least 50 years, at an annual cost which would not exceed the \$3.6 million already provided in the state budget for leasing 535,000 square feet of comparable space.

- Included in the total office space leased in Sacramento is 225,000 square feet at an annual cost of \$1,494,000. The state could construct a building of this size, approximately equivalent to the size of either building 8 or 9, for about \$12,227,000.

The current annual rate of \$1,494,000 for the leased facilities is sufficient to pay for maintenance and operating costs of a state-owned building, as well as its costs of construction and financing in 22.4 years.

- Included in the total office space leased in central Los Angeles is 310,000 square feet at an annual cost of \$2,165,000. Included in this amount is the pending lease

described earlier for the Department of Justice and the courts. The state could construct an office building of this size for about \$16,735,000.

The current annual rate of \$2,165,000 for the leased facilities is sufficient to pay for maintenance and operating costs of a state-owned building, as well as its costs of construction and financing in 19.6 years.

Calculations of these costs are shown in Table 1 on the following page.

Table 1

	<u>Sacramento</u>	<u>Los Angeles</u>	<u>Total</u>
Cost of Construction: ^{a/}			
225,000 ^{b/} square feet in Sacramento	<u>\$12,227,000</u>		
310,000 ^{b/} square feet in Los Angeles		<u>\$16,735,000</u>	
Total Cost of Construction			<u>\$28,962,000</u>
Annual lease costs as of January 1974 contained in state's budget	\$ 1,494,000	\$ 2,165,000	\$ 3,659,000
Less estimated value of maintenance and operating costs included in lease rates, based on state- experience rate	<u>-586,000</u>	<u>-807,000</u>	<u>-1,393,000</u>
Remaining amount of annual lease costs available for payment of principal and interest on new construction	<u>\$ 908,000</u>	<u>\$ 1,358,000</u>	<u>\$ 2,266,000</u>
Number of years required to finance principal and interest at 5 percent with annual payments of \$908,000 and \$1,358,000, respectively	22.4 years	19.6 years	

NOTE: This example is for illustrative purposes only and is not meant to be an endorsement for construction of a particular size building. Such a determination would have to be based on the long-range needs of the state and the availability of funds for financing at the time.

^{a/} These amounts are based on estimates by the Office of Architecture and Construction in the spring of 1974 using projected July 1974 construction cost indexes.

^{b/} Total of 535,000 square feet.

In the fiscal year 1974-75 budget, \$1.5 million has been included for preparation of preliminary plans and working drawings for a new state building in Los Angeles and for the demolition of an existing state office building. However, as previously noted, a high-cost, five-year lease for office space to be occupied beginning in September 1974 has been executed by the state.

By using the amounts budgeted for leasing high-cost office space, the state could finance construction of office buildings to meet its needs for comparable space, and have the additional benefit of full ownership in a period of less than one-half of the buildings' useful lives. We recognize that during the time that buildings are being constructed and prior to their being available for occupancy that payments for existing leases as well as for construction financing costs must be incurred.

RECOMMENDATION

We recommend that the department request that monies currently appropriated on an annual basis in the state's budget for leasing high-cost office space be used instead to finance construction of office buildings.

SAVINGS

Based on current lease rates and the size buildings discussed in this report, proper implementation of this recommendation will result in estimated cash savings to the state of approximately \$66,000,000 over the remaining useful life of the buildings after full payment of the construction and interest costs. Further, the state will have full ownership of these buildings.

THE DEPARTMENT OF GENERAL SERVICES
HAS NOT RELEASED A REPORT OF STATE
BUILDING REQUIREMENTS AND PLANS FOR
SATISFYING THOSE REQUIREMENTS, EVEN
THOUGH THE REPORT WAS REQUIRED TO BE
SUBMITTED TO THE JOINT LEGISLATIVE
BUDGET COMMITTEE BY NOVEMBER 1, 1973.

The Supplementary Report of the Committee on Conference relating to the Budget Bill of 1973-74 required the Department of General Services to submit to the Joint Legislative Budget Committee by November 1, 1973 a report of state building requirements and plans for satisfying these requirements for each metropolitan area in which state offices are located.

At July 31, 1974 the report still had not been released. Department of General Services' officials stated that it had transmitted the report to the Agriculture and Services Agency which reviewed the report and requested various revisions to it.

At our request, the Department of General Services allowed us to review the unreleased report. Included in the report were recommendations that the state construct by 1985 a total of eight state office buildings. Three of these buildings, totaling 243,000 square feet each, are to be located in Sacramento and are to be ready for occupancy in 1985. The remaining buildings would be located in Los Angeles, San Diego, San Jose, Oakland and Long Beach and are to be ready for occupancy between 1980 and 1985.

The report recommendations are based upon current state space needs and the projected needs over the next 10 years. The analysis by the Department of General Services of current and future state space needs were developed primarily from data pertaining to projected population growth,

future state expansion, and existing leased facilities of state agencies.

In our judgment, this report contains valuable information pertaining to the state's office space needs.

RECOMMENDATION

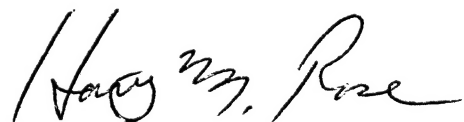
We recommend that the Department of General Services immediately release its report on state building space requirements and plans to the Joint Legislative Budget Committee for their review and consideration.

BENEFITS

Implementation of this recommendation will enable the Legislature to better evaluate the state's office space needs.

SUMMARY OF COMMENTS OF THE DIRECTOR
OF GENERAL SERVICES AND HIS STAFF

1. A conceptual plan has been formulated to construct an office building in Los Angeles, containing approximately 500,000 square feet. This building would be constructed on the site where an existing state office building is to be demolished. If the conceptual plan is followed and necessary funds are subsequently appropriated to finance construction of this proposed office building, it is estimated that the building could be occupied at the completion of the recently executed five-year lease for office building space in Los Angeles.
2. A final revised report of state building requirements and plans for satisfying these requirements for each metropolitan area in which state offices are located will be released in the near future.



Harvey M. Rose
Auditor General

August 6, 1974

Staff: Glen H. Merritt
Curtis I. Davis
Bill L. Myers
Tony Bolobnow